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THE UNITED STATES WAREHOUSE ACT AND ITS
RELATION TO BANKING

By H. S. Yohe,
In Charge, Administration U.S. Warehouse Act.

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In coming before you to speak about the United States warehouse Act and its relation to the farmer and banker of South Carolina, I do so without any apologies or explanations because, first, the bill was introduced by one of your own fellow citizens, Honorable A. F. Lever, when he was Chairman of the Committee of Agriculture in Congress, and, second, because the demand for this bill came from the cotton growers of the south. While the demands of the various cotton growers were crystallized into a bill by your own fellow citizen, strange as it may seem, less use has been made of the Warehouse Act by the farmers and bankers of South Carolina than any cotton growing state save Texas and Oklahoma. It would seem then that this is sufficient justification for my appearing to explain this law to you.

Let me go back into history a little. You will recall with the breaking out of the European War in 1914 that the Liverpool Cotton Exchange closed on July 31 of that year. Promptly on its heels the New York and New Orleans Exchanges closed. On the day of closing of the New York Exchange, December options of middling cotton were quoted at 10.75. By the middle of August unofficial quotations were made at 10¢ on middling cotton and by October unofficial quotations had dropped to 7¢ for December options. At many interior points almost any amount of middling cotton could have been bought at 5¢. You will recall those years. That was the time when we heard the cry "Buy a bale of cotton". The cotton growers had the biggest cotton crop fast maturing which they ever produced. The banks in the north and east were literally bulging with money. But with the closing of the cotton exchanges the cotton markets were gone and nowhere was money to be found to loan on cotton. Under these conditions the cotton growers and men who had given thought to cotton problems and leading agriculturalists felt that something should be done to relieve the cotton grower and enable him to pay off his fast maturing production credit loans.

A few days following the closing of the cotton exchanges, Mr. Lever introduced the first draft of the Warehouse Act. It applied

only to cotton. A few days later another bill was introduced along similar lines which applied to grain only. This was back in 1914. The emergency passed before the different bills actually were crystallized into law, which did not happen until August 11, 1916.

Now what are the purposes of the United States warehouse Act?

First, the Department of Agriculture and various agriculturally-minded Congressmen recognized that the cotton farmer, particularly in many states, did not store his cotton properly. Frequently he left it in the open in direct contact with the ground. The old open cotton yard was found in practically every state. Under these methods of storage tremendous economic loss was sustained by the country annually through so-called weather damage. This loss was estimated to range from \$30,000,000. to \$70,000,000. each year. Congress felt then that an attempt to relieve the situation through legislation must be along lines which would encourage the farmer to store his crop in proper warehouses. But why did the farmer not store his crop? This question suggested the second purpose of the warehouse law; namely, the elimination of evil and unsound practices in warehousing. Scattered over the cotton belt were innumerable examples of loss resulting to farmers who had stored their cotton with public warehousemen. Perhaps when they came for their cotton they found that an inferior cotton had been substituted or many times they found that there was no cotton in that warehouse at all. The second purpose .. then of the Warehouse Act was to eliminate evil and unsound warehousing practices so that the farmer who stored his products in a warehouse might be reasonably certain that the same products would be there when he wanted delivery.

The third purpose of the law was to encourage orderly marketing of the products. But orderly marketing could not take place unless the farmer was in position to pay off his production credit. This he could not do except by selling the crop when harvested. Farmers throughout the cotton belt all engaged in selling the crop at one time which meant throwing more on the market than it could consume. The result was, prices were driven down. It was reasoned that if some means could be found which would enable the farmer to borrow on the basis of his harvested crop a sufficient amount to pay off his production credits, he would then be in position to withhold marketing all of his crop at that time. A means which suggested itself to those who had given the problem some thought was a warehouse receipt which would carry upon its face such information as would make for proper identification of the product while in storage and enable the banker upon reading the receipt to determine a fair loan value for the product. This meant that the receipts must carry information which would identify the product and which would give in the case of cotton the weight of the cotton and its grade and staple and whether or not the product was insured and to what extent. It also meant that the warehouse receipt must constitute an enforceable contract between the farmer depositing the cotton and the warehouseman who stored it.

The fourth great purpose of the Warehouse Act was to develop a form of warehouse receipt containing such terms and conditions as to make it acceptable generally to the bankers as security for loan purposes regardless of the proximity of the banker and the issuing warehouseman or what the banker might know about the borrower. In other words, a receipt which translated into terms of value the particular product placed in the warehouse by the depositor.

The United States warehouse Act applies only to public warehousemen. It does not apply to the farmer's barn, to a cow shed or a farm hand's cabin or garage. It is applicable only to warehouses which are operated as public warehouses and which receive the products of farmers without discrimination.

It functions through a system of licensing warehousemen and inspectors, weighers and graders by the Secretary of Agriculture. Only such warehousemen and inspectors, weighers and graders can be licensed as can meet the requirements stipulated by the Department of Agriculture. In the case of warehousemen, this means that the organization must be legally formed. It must have back of it certain financial responsibility. The officers of the organization must be men who are honest and competent and must know how to care for the products to be stored. This means that the organization must be closely investigated. You men as bankers know the importance of thorough investigation in this direction. How many times have you held warehouse receipts as collateral concerning the value of which you had some doubt? The Department cannot afford to license warehousemen indiscriminately. To do so would defeat the very purposes of the Warehouse Act. You men as bankers would have little confidence in receipts issued under authority of the Warehouse Act if the Department licensed warehousemen without thorough investigation. What banker in Charleston would be justified in loaning on the basis of a warehouse receipt issued at Greenville without first making a personal investigation of the warehouseman unless he understood the Department had thoroughly investigated the warehouseman before it licensed him? The need for close scrutiny of financial statements submitted by warehousemen is apparent to you all as bankers. How frequently have you been tendered financial statements which showed handsome surpluses but which upon investigation disappeared? How frequently have you been tendered warehouse receipts ^{issued} by so-called warehousemen when as a matter of fact they were not warehousemen in any sense of the word but were really custodians of their own product? Again and again the Department has been obliged to deny licenses because financial statements which were filed were inadequate or grossly padded or because the management had in it persons who were not to be trusted. You men as bankers can recall cases without me reciting them where banks have been left to hold empty bags due entirely to unsound warehousing practices. It is essential, therefore, that close investigation shall be made to determine the competency, the financial responsibility and the honesty of the warehouseman and the persons in active charge of the

warehouse. Likewise, it is essential that the Department should satisfy itself regarding the competency and honesty of people who are to inspect, grade and weigh the products for be it remembered that the Warehouse Act contemplates that every warehouse receipt shall contain a clear and accurate statement of the quantity of the product and its grade and condition. No banker can loan intelligently without such information. Many of you can recall instances where warehouse receipts have been issued under so-called approved systems and under different laws when as a matter of fact there was doubt in the first place as to whether there was such a warehouse or whether the commodities which were represented by the receipts were actually in existence.

While sound discrimination must be exercised in determining who shall and who shall not be licensed, this is only the beginning of the part the government plays in making warehouse receipts for agricultural products real collateral. The backbone of the Warehouse Act is in the supervision exercised by the Department after a warehouseman is licensed. Just as national banks are subjected to examination from time to time by disinterested government officials so are all Federally licensed warehouses subjected to inspection and examination after the license is once issued. These investigations are made at irregular intervals. No warehouseman knows what day the government examiner will call. These examinations not only relate to the factors originally considered when the warehouseman filed the application for licensing but they extend still further. A check must be made to determine whether receipts have been issued properly in the first place, whether they have been returned and properly cancelled before delivery of products, and that for all outstanding receipts there are actually in the warehouse the products covered by those outstanding receipts.

There are three outstanding cardinal principles in the Warehouse Act which must be observed.

First, that no receipt shall be issued until the product is actually in the hands of the warehouseman and in the warehouse. This seems to be quite elementary, and it is, and yet how frequently banks have sustained losses by making loans on the basis of receipts covering products which either never had been in the warehouse or which were never in existence. At the other end, is the principle that no product shall be delivered from the warehouse until the receipt represented by that product is surrendered and cancelled by the warehouseman. Again an elementary principle. Both these principles are incorporated in the Uniform Warehouse Receipts Act and yet how frequently the principle of delivery prior to the return of receipts is violated. A good customer of a warehouseman wants to make delivery and consummate a sale today but hasn't the money to lift the warehouse receipt so he goes to his warehouseman and asks him to load the product in the cars so that he can get the bill-of-lading and take it to the banker to exchange for the warehouse receipt and the warehouse receipt will be surrendered to the warehouseman. This is a so-called ac-

commodation to the depositor. The warehouseman reasons he knows the depositor. The banker may know that such a transaction is taking place but raises no protest. Some day the process is repeated once too often. The warehouseman is again requested to make delivery prior to the return of the receipts. He assumes that the receipts will be returned as they were on previous occasions and that the obligation will be properly cared for. But on this particular occasion the goods are delivered, the receipts are not returned and the banker knows nothing of the transaction until it is too late. Now, of course, some of you bankers may reason that you know your customers. We have heard that answer many a time but the answer to your contention is that just that very method has left losses scattered in practically every state in the Union - losses due to a violation of a simple and elementary and a thoroughly sound principle of warehousing and sound banking. I need not dangle before you any skeletons. I am confident that at least some of you have these skeletons in your own closets. It is always unpleasant to be reminded of such circumstances, nevertheless, I direct your attention to these skeletons simply because too frequently we have bankers, who as members of this association, tell us that they know their warehousemen and they know their customers and they know that they are on the safe side, when as a matter of fact we know that these principles are being violated.

The third principle which is fundamental to the Warehouse Act is that the receipts shall bear identification marks of the products in storage so that if perchance one of your clients failed to make good his obligations you are in position to go to the warehouseman and demand the particular commodities represented by the warehouse receipts. Now this principle again is flaunted in every cotton growing state. The warehouse receipt reading so many bales and so many pounds, with no statement of grade, condition or individual identification marks of each bale is a worthless piece of collateral to the banker when he faces the acid test. That test is nothing short of bankruptcy of your client. Suppose your client becomes bankrupt and suppose at the same time the warehouseman becomes bankrupt, - and this isn't an unheard of illustration - and you are holding a receipt for 100 bales of cotton without proper identification and the weight and grade of each individual bale, are you in position as a banker to go to the trustee in bankruptcy of the warehouseman and demand any particular 100 bales of cotton to satisfy your obligations? Is the trustee going to deliver you any 100 bales or is he going to insist that your warehouse receipts must give him identification so that he will be certain that he is not delivering to you cotton which belongs to some other depositor in that warehouse? Or take a case not quite as extreme. Suppose only your client becomes bankrupt and you take your warehouse receipt for 100 bales of cotton without proper identification to your warehouseman, can he deliver to you any 100 bales which that particular client had in the warehouse? Or is he likely to be restrained by the trustee in bankruptcy of your client who is charged with the duty of collecting all possible assets for the benefit of creditors? In short, the question is - does the so-called block form of warehouse receipt, without specific identification

of the bales covered by the receipt, place you in the position of a preferred creditor, as so many of you bankers think you are when you take a warehouse receipt, or does it leave you in the position of a common creditor? Any note which is made to cover any product which is supposed to have back of it collateral for a loan is not in accord with sound principles of credit and banking unless it is supported by a receipt which makes for specific identification of specific products, or at best in the case of fungible products, which assures delivery of an equal amount of like kind, grade and condition as is recited in the receipt. How many of the usual so-called block cotton warehouse receipts issued outside of the United States warehouse act give you information with respect to the identification, the weight, the grade or the condition of each of the bales covered by the receipt?

I call your specific attention to these three cardinal principles; namely, the issuance of a receipt only after products are in the custody of the warehouseman and in the warehouse; the delivery of goods only upon surrender of the warehouse receipt and the necessity for proper specific identification because apparently more losses have resulted from the violation of these three principles than from all other sources combined. You men all know of losses due to improper delivery. You men can recall losses due to issuance of receipts when goods were not in the warehouse and certainly all know of losses which have resulted from a substitution of inferior products for good products. Such substitution would not have been likely to have been practiced if there had been proper specific identification in the first place.

And now let me call your attention to the methods of warehousing of agricultural products which appear to have been practiced in this country and I shall leave it with you to draw your own conclusions as to which method makes for the issuance of the soundest warehouse receipt. But before doing so, let me remind you that a primary essential to a properly collateralized loan is disinterested custodianship of the collateral. You men all know the position that the Federal Reserve Board takes with reference to disinterested custodianship of the agricultural products. You know that acceptance paper to be eligible for rediscount must be supported by warehouse receipts which represent disinterested custodianship of the product. Now in warehousing agricultural products we have, first, the instance of a cotton merchant whose business primarily is dealing in cotton or a grain merchant whose primary business is dealing in grain or any other type of merchant. He places goods in his own warehouse and issues a receipt to himself which he offers to you as a banker as security for a loan while he acts as the custodian of the goods which are your security. Obviously this is not a case of disinterested custodianship. In the next place, the same cotton merchant may also receive cotton from farmers and merchants, place it in his warehouse and issue them a warehouse receipt which they offer to you as security for a loan. It is, of course, apparent that the

receipt issued to these outside parties is a different type of receipt from that issued by the cotton merchant to himself on his own goods in his own custody. As to the goods which were placed in the warehouse by parties other than the merchant himself, it is apparent that the merchant is a disinterested custodian and therefore the receipts which he might issue will represent disinterested custodianship and are eligible for rediscount in connection with acceptance paper with the Federal Reserve Banks.

The third type of warehousing, which we find practiced quite extensively, is what we know as the subsidiary warehousing corporation. A typical instance is a corporation engaged in the cotton business. It intends to borrow in large volume. It knows its local banks cannot supply it unless the bank can rediscount its paper with other rediscounting banks in other cities or with Federal Reserve Banks. The corporation, therefore, forms a subsidiary corporation for purposes of warehousing. This warehousing corporation is manned by officers or employees of the parent corporation. A receipt is issued reading "Received from A.B.C. Cotton Company so many bales of cotton - signed: X.Y.Z. Warehousing Corporation". On the face of this receipt it would appear that the X.Y.Z. Warehousing Corporation is in no way related to the A.B.C. Cotton Company and that there is disinterested custodianship of the cotton. As a matter of fact, the parent corporation, the A.B.C. Cotton Company, completely controls and dominates the X.Y.Z. Warehousing Corporation. It has selected the officers of the X.Y.Z. Warehousing Corporation. Frequently the same people who are officers in the parent corporation are officers of the subsidiary corporation but the precaution is usually taken that the man who is general manager of the warehouse company and who signs the receipts does not appear among the officers of the parent company. Nevertheless, it isn't a stretch of the imagination to conclude that he was selected and is dominated by the officials of the parent corporation. Obviously then, in such a case the subsidiary warehousing corporation is a mere subterfuge and the principle of disinterested custodianship is violated. With such receipts, no banker should be at all surprised, when he offers paper supported by them for rediscount, if he is denied. It is possible to create a subsidiary warehousing corporation which will meet the principle of disinterested custodianship but the lines must be strictly and sharply drawn and the principle of disinterested custodianship must be strictly observed.

A fourth type of warehousing, which to my knowledge is not in effect in your section, is that which is known as "Field Warehousing". Under this plan the cotton merchant, whom we first mentioned, would lease the warehouse to a party, in no way interested or related to the cotton merchant, to operate it as a public warehouse. This lessee takes complete charge and control of the building by virtue of a valid lease. He receives the cotton merchant's cotton in storage just the same as cotton of a farmer or other depositor. He exercises complete control and dominion over the warehouse and the products stored therein

to the exclusion of the cotton merchant and other depositors. In other words, he assumes full responsibility for the operation of that warehouse, the only relation between him and the owner of the warehouse, the cotton merchant, being that of lessor and lessee. In some sections of the country it is not uncommon for a warehouseman in some city to lease a number of houses in a number of points scattered throughout the state and operate on this principle of field warehousing. Field warehousing is sound if proper precautions are taken to see that the principle of disinterested custodianship is strictly observed. But it will not do for a warehouseman to lease a building and then let the party or employees of the party who may wish to store his cotton therein run the warehouse and conduct it just as they did before the lease arrangement. The lessee must exercise complete control and dominion over the warehouse and products stored therein at all times. This does not necessarily mean that the lessor, the cotton merchant, must be denied access to the warehouse at all times but it does mean that he must be denied access except in the presence of the lessee or his duly constituted agent. Field warehousing can be made to operate on a sound basis and serve a real economic need to give the banker sound collateral but again lines of demarcation must be clearly and sharply drawn, otherwise, the leasing of the warehouse becomes a mere subterfuge and the principle of disinterested custodianship is violated.

The fifth type of warehousing, which is practiced in every state in the Union, is that which you bankers generally think of when you think about warehousing; namely, where a corporation or a partnership or an individual operates a warehouse as a strictly business proposition, receiving goods from any and every one without any interest whatever in the goods on the part of the warehouseman. The warehouseman's position is that of a custodian without any interest whatever in the product beyond that of custodian. His big job is to see that the goods which were entrusted to him are kept in proper condition and are there for delivery when the warehouse receipts are surrendered. This is what we sometimes style "pure warehousing".

From what I have said it must be apparent to you which type of warehouseman would be in position to issue the most preferable receipt.

Let me in conclusion remind you that the Federal Warehouse Act grew out of a condition existing in the cotton growing states; that it was the answer on the part of Congress to a demand made largely and most insistently by the South and that that demand came not only from growers but from bankers. It has now been in effect ten years. In that time it has demonstrated its usefulness. The contention of your own fellow citizen, Honorable A. F. Lever, who introduced and sponsored the bill through Congress, has been vindicated. It has served the whole country in no small measure and it has served not only the farmer but the merchant, the warehouseman and the banker. The beginning has

only been made. How much further it may serve the agriculture of your state will depend largely on the attitude of you men as bankers. If you are going to accept warehouse receipts without information which enables you to determine fairly and intelligently the loan value of a product, without information which permits you when perchance you must face the acid test to demand of a warehouseman certain products by virtue of certain information contained on the warehouse receipt - if you are going to accept warehouse receipts simply because you know the warehouseman who issues them and have confidence in him or because you know your client and have confidence in him - of course, the Federal Warehouse Act will not serve you.

Bear in mind that there are all kinds of warehouse receipts. Some, which on their face appear prima facie gilt edge. Bear in mind also that back of these receipts there may be certain laws, but don't forget that the best law that it is possible for man to draft is not likely to make for sound collateral unless there is sound regulation back of the law, and, don't forget that sound law coupled with sound regulation don't make for sound collateral of themselves. Back of sound law and back of sound regulation there must be sound, fearless, impartial administration.

The Federal Warehouse Act has brought hundreds of millions of dollars of capital from the North and East into the agricultural producing areas. It has made it possible for bankers in agricultural producing areas to do a larger volume of business and to meet the needs of their home communities. It has brought money at cheaper rates to the producers. It has eliminated many of the evils and risks which were the cause of high interest rates and which frequently resulted in a lack of interest on the part of metropolitan capital. I might recite illustration after illustration showing how the Federal warehouse receipt has served in this state and that state and every agricultural state.

As I said in the beginning, it has been used less in South Carolina than in many other states and that despite the fact that the father of the law is one of your own citizens. It is a demonstrated fact of accomplishment. It protects the grower, the warehouseman and the banker. In this day of need of agriculture, are you, as a banker, quite fair to your agricultural interests if you accept as collateral anything short of the best type? To put it even more selfishly, are you quite fair to your depositors or to your stockholders, if you don't insist on having the type of collateral which is generally recognized as the outstanding form of warehouse receipt? Still more selfishly, are you quite fair to yourselves as officers of banks if you don't demand the best available?

I would not have you believe that there are no warehouse receipts issued outside of the United States Warehouse Act that are not as good as those issued by warehousemen operating under the Warehouse Act, but,



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in all fairness to you as men extending credit and who ought to be protected, isn't it fair to conclude that if a warehouseman not operating under the Warehouse Act is in position to issue a first-class piece of collateral that operating under the Act simply adds that much more to the value of his collateral and gives you that much more protection.

Let me say in conclusion - whether or not the Federal Warehouse Act will be used on a larger scale in South Carolina depends largely on the attitude that you bankers take. The farmer has nothing to lose by being obliged to give a Federal warehouse receipt to get a loan. The warehouseman has nothing to lose by operating under the law. On the other hand, he ought to have considerable to gain. And surely the banker has nothing to lose by demanding the Federal warehouse receipt. We are ready to serve you but you and your clients must make the demand.

End.